SUPREME COURT, U. S.

NOV 22 1968

JOHN F. DAVIS, CLERK

IN THE

Supreme Court of the United States

October Term, 1968.

No. 766

HARRY R. LEA and ROSLYN T. LEA, Co-Partners trading as HARRY R. LEA & COMPANY,

Petitioners,

v.

CONSOLIDATED SUN RAY, INC., SUN RAY DRUG CO., BARGAIN CITY, U.S.A., INC.,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT.

ARTHUR R. LITTLETON,
123 South Broad Street,
Philadelphia, Pa. 19109
Counsel for Petitioners.

Of Counsel:
MORGAN, LEWIS & BOCKIUS.

International, 711 So. 50th St., Phila., Pa. 19143—Tel. SA 7-8711 Area Code 215

INDEX.

	Page
OPINIONS BELOW	1
JURISDICTION	1
QUESTION PRESENTED	1
Is it not a violation of the petitioners' right of due process of law for a judgment in excess of $580,000 to be sustained when a factual conclusion of the court necessary to sustain such judgment has *absolutely* no supporting evidence in the record?	
STATUTE INVOLVED	1
STATEMENT OF THE CASE	2
REASONS FOR GRANTING THE WRIT	6
1. The Decision of the Court of Appeals Draws the Factual Conclusion Necessary to Sustain Liability From a Record Devoid of Any Evidence, Even the Slightest, to Support Such Conclusion	6
2. The Opinion Accepts a Calculation of Damage in the Amount of $580,023 and in So Doing Ignores the Stipulation of the Parties as to Such Calculation	9
CONCLUSION	10
APPENDIX:	
Circuit Court Order Denying Petition for Rehearing	11
Circuit Court Judgment	12
Circuit Court Opinion	13
District Court Opinion	31
District Court Order Denying Defendants' Motion for Judgment	44

TABLE OF CITATIONS.

Cases:

	Page
Chicago Life Insurance Co. v. Cherry, 244 U. S. 25, 37 S. Ct. 492 (1916)	6
Hilton v. The Federated Brokerage Corp., 213 N. Y. S. 2d 171, 30 Misc. 2d 503 (1961)	4, 7
Thompson v. Louisville, 362 U. S. 199 (1960)	2, 6

Statutes:

	Page
U. S. Constitution, Fifth Amendment	1
28 U. S. C. A. § 1254(1)	1

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT.

Petitioners pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Third Circuit entered in the above matter on September 16, 1968.

OPINIONS BELOW.

The opinion of the District Court is reported at 276 F. Supp. 132 and is printed in the Appendix to this petition at page 31. The opinion of the Court of Appeals is unreported and is printed in the Appendix to this petition at page 13.

JURISDICTION.

The judgment of the Court of Appeals was entered on September 16, 1968. A timely petition for rehearing was filed and subsequently denied on October 16, 1968. The jurisdiction of this Court is invoked under 28 U. S. C. A. § 1254(1).

QUESTION PRESENTED.

Is it not a violation of the petitioners' right of due process of law for a judgment in excess of $580,000 to be sustained when a factual conclusion of the court necessary to sustain such judgment has *absolutely* no supporting evidence in the record?

STATUTE INVOLVED.

This case turns upon the interpretation of the Fifth Amendment to the Constitution of the United States which provides in material part as follows: "No Person . . . shall be deprived of . . . property, without due process of law".

STATEMENT OF THE CASE.

This suit is the civil counterpart of the "Shuffling Sam" case [1] recently decided by this Court wherein it was held that a conviction, *unsupported by any evidence,* was a violation of due process. A like violation of due process is as clear in the instant case.

The petitioner (Lea) is an insurance broker. The plaintiffs are affiliated corporations which in 1959 sought specific fire insurance coverage through Lea to cover all their various stores and enterprises. Through the efforts of Lea, a policy was obtained from the Steel Insurance Company which was to insure a great number of contingencies but, when delivered, did not cover two or three of the contingencies required by the plaintiffs.

Consequently, Lea undertook to have these errors in the policy corrected. The corrections were to have one of the plaintiffs, Bargain City, U. S. A., Inc., named as a party assured and not merely included under the term "affiliate or subsidiary" of Consolidated Sun Ray, Inc.[2] The corrections were also to add "Use and Occupancy" insurance in order to provide funds during the time that the assureds were not able to use and occupy damaged buildings. Lea took steps to have these corrections made but at the time of the fire in question there were no written endorsements by Steel Insurance Company correcting the errors in the policy. Instead there were specific binders from agents of Steel

1. The popular name for *Thompson v. Louisville,* 362 U. S. 199 (1960).

2. The Court of Appeals found that Bargain City was not an affiliate and thus not covered, overlooking an admission by the plaintiffs that Bargain City was an affiliate and came within the coverage appearing at pages 221a and 222a of Appellants' Appendix in the Court of Appeals which has been certified to this Court with the record below and ten copies of which have been filed in this Court.

which were intended to provide the missing coverage and premiums were paid based on such coverage.

The plaintiffs having suffered extensive damage in a fire in December 1959 and having made proper proof of loss, sued the Steel Insurance Company upon the policy after it refused to acknowledge coverage.

The insurance company defended this suit by not only denying that the binders obtained by Lea provided the coverage sought but also upon the ground that it had been provided fraudulent loss history information at the time of the application for the policy. The insurance company asserted that, had it been provided with the true loss history information, it would not have issued the policy.

Most importantly for purposes of the instant case, this defense of "fraud in the loss history" was categorized by Steel Insurance Company as its *primary defense.*[3]

Subsequent to the commencement of their action against Steel Insurance Company, the plaintiffs sued Lea, their broker, on the theory that if the policy did not fully cover them (as the insurance company was then asserting) Lea had been negligent in obtaining a defective policy. This is the suit now before the Court.

Of the two actions, the one against Steel Insurance Company came to trial first. After three days of plaintiffs' testimony it was settled by the payment of $475,000 to the plaintiffs, which was $275,000 less than the policy limits. Plaintiffs settled the suit because of the existence of four colorable defenses raised by the insurance company, one of which was the alleged "fraud in the loss history".

Following this settlement, these plaintiffs proceeded in the instant suit to claim the difference between the settlement figure and the policy limits on the theory that Lea's negligence had provided the insurance company with *all* the

3. The last two lines of the insurance company's memorandum at page 225a of Appellants' Appendix filed in the Court of Appeals.

colorable defenses, thus forcing the plaintiffs to settle the suit.

The instant case was tried and argued on this theory. Lea defended, inter alia, on the basis that plaintiffs had the burden to prove, by a preponderance of the evidence, that Lea was responsible for the existence of *all* the insurance company's defenses *including the alleged "fraud in loss history"*.

It is and always has been Lea's position that if the plaintiffs fail to establish by proper evidential proof that Lea was responsible for the existence of the "fraud in loss history" defense, no recovery whatsoever can be granted to the plaintiffs, regardless of whether or not Lea was responsible for the other Steel defenses. This is inevitable because the evidence did not allocate portions of the settlement figure to each of the four specific defenses. Lea's position in this has never been refuted by the courts or the plaintiffs and has ample support in logic and in the law. *Hilton v. The Federated Brokerage Corp.*, 213 N. Y. S. 2d 171, 30 Misc. 2d 503 (1961).[4]

As was stated by the lower court during oral argument, this matter was submitted on an "all or nothing basis" by both parties. It was argued on that basis to the lower court and the Court of Appeals. Both courts concluded that *all* of the defenses were the responsibility of Lea.[5]

In so concluding, however, they failed to point to any statement or any fact in the extensive record which even remotely supports the conclusion that Lea was responsible for the existence of the "fraud in the loss history" defense. *There is not one shred of evidence to this effect,* let alone proof by the necessary preponderance of evidence.

---

4. The only case on point found by either party.

5. District Court p. 41 hereof; Circuit Court p. 29 hereof.

Lea has throughout challenged, not only the courts but also the plaintiffs, to point to any part of the record which factually supports this devastating conclusion. To this date no one has ever pointed to any reference in the record.

Lea again challenges the plaintiffs to do so in replying to this petition.

REASONS FOR GRANTING THE WRIT.

This court should grant certiorari because in concluding that Lea was responsible for the existence of the Steel defense of "fraud in the loss history" (and thus liable for payment of over $580,000) the lower court did so upon a record devoid of any evidence on the subject.

1. The Decision of the Court of Appeals Draws the Factual Conclusion Necessary to Sustain Liability From a Record Devoid of Any Evidence, Even the Slightest, to Support Such Conclusion.

As was stated in the "Shuffling Sam" case,[6] "Just as 'Conviction upon a charge not made would be sheer denial of due process', so is it a violation of due process to convict and punish a man without evidence of his guilt".

Similarly, in a civil case, no judgment should be upheld nor the defendant made to pay any sum, no matter how large or small, if the record does not contain even the slightest hint of evidence to support the judgment.

While it is true that there is more emotional and human sympathy toward a person who has been convicted of a crime upon no evidence, it is no less unjust nor less violative of the underlying constitutional mandate of fundamental fairness to have a civil defendant subjected to a similar violation.

This case is not one in which an erroneous judicial decision has been made upon facts of record, a situation clearly not a violation of due process. *Chicago Life Insurance Co. v. Cherry,* 244 U. S. 25, 37 S. Ct. 492 (1916).

While human errors are contemplated in the concept of due process, such errors are limited to erroneous conclusions from existing facts and do not include judgments based upon an evidential void.

---

6. *Thompson v. Louisville, supra,* at p. 206.

The instant suit involves a judgment rendered upon *no evidence.*

This case turns upon the requirement that the plaintiffs prove a causal connection between the existence of the "fraud in loss history" defense and the actions of Lea. Without this proof, no court can properly say that Lea was responsible for the *entire* difference between the settlement figure and the policy limits.

Since the plaintiffs did not produce evidence as to the proportional influence of each of the defenses upon the settlement, petitioners have insisted throughout this case that, before any monetary liability can be assessed, adequate proof must be furnished the court to demonstrate that Lea was responsible for *all* the defenses and not just some of them.

As was said in *Hilton v. The Federated Brokerage Group, supra,* the plaintiff, who seeks to recover the difference between a settlement of a policy and the policy limits from his broker, as an "integral part of his cause of action, as an indispensable condition, as a sine qua non, must prove that recovery from a carrier was precluded or reduced *solely* by reason of the (broker's) error". (Emphasis the Court's.)

This case, therefore, rises or falls upon what evidence there is in the record to support the conclusion of the courts that Lea was responsible for the existence of the "fraud in loss history" defense.

It is and always has been the position of the petitioners that there is no such evidence in this record, *not even evidence which can be erroneously construed to establish that fact.*

To sustain a judgment against Lea would be to sustain a judgment with no evidential basis, similar to "Shuffling Sam's" conviction.

The Court of Appeals does not state what evidence supported its conclusion; it merely jumps to the conclu-

sion,[7] without even discussing whether Lea's main argument that the plaintiffs must prove his liability for *all* defenses was a valid argument or not.

The District Court discussed the question [8] but did so without relation to any evidence in the record. That court, acknowledging that Lea never sought prior loss history information from the plaintiffs, merely assumed, with no evidence to support such an assumption, that the insurance company had requested information in regard to prior history from Lea. As a consequence that court concluded that it was Lea's responsibility to provide the same. The District Court did not point to evidence of record for one good reason: *there is no such evidence.*

This entire record mentions the subject of "prior loss history" only at that point where it is established that Steel raised such as a defense. No further evidence on the subject is contained in the record. The documents proving that the defense was raised in the insurance company case were admitted in this case pursuant to a specific stipulation [9] which states that "The Court may consider as indicative of the defenses raised by the Steel Insurance Company to the claim of the insured in (the action against the insurance company) the following documents" . . . then follows a list of pleadings filed in the Steel action, which clearly establish that fraud in the prior loss history information was the insurance company's "*primary* defense".

In the above circumstances and by reason of the failure of the lower courts to even discuss the legality of the petitioners' *main* argument and the failure of either court or of the plaintiffs to point to *any* evidence establishing who

7. Appendix hereof p. 29.

8. Appendix hereof p. 41.

9. Supplemental Stipulation No. 3, p. 26a of Appeliants' Appendix in the Court of Appeals. See also footnote 3, *supra.*

caused the "fraud in the loss history" defense to exist, it is clearly a violation of the petitioners' right of due process of law to enter a judgment against them since the establishment of this causal connection is essential to their entire liability.

2. The Opinion Accepts a Calculation of Damage in the Amount of $580,023 and in So Doing Ignores the Stipulation of the Parties as to Such Calculation.

At the conclusion of its opinion, the Court of Appeals accepts the calculation of $580,023 as the damage, including interest. In so doing it ignores stipulation 45 [10] in which the parties agree that, following the settlement of the Steel Insurance Company suit, there was a "net balance of claim of $275,000 plus interest thereon to date".

A calculation of interest at 6% per annum on such agreed figure from a date sixty days after the fire (as agreed by all parties) up to and including the date of judgment, September 28, 1967, shows interest to be $125,400 on a 365-day basis.

The lower court, in reaching the $580,023 figure, accepted the plaintiffs' calculations submitted to it by a letter in which interest was calculated on the face value of the policy over the same period *before* deducting the settlement figure. This was contrary to the stipulation between the parties.

The calculation of the plaintiffs was never stipulated to in the lower court by counsel for the petitioners; and the opinion of the lower court is incorrect in setting forth that the stipulated figure is $580,023. Stipulation 45 was the only stipulation made in the lower court by counsel for

10. Page 16a of the Appellants' Appendix filed in the Court of Appeals.

the petitioners; and the record supports only the lower figure, $275,000 plus $125,400 or $400,400. The difference between the figures is substantial.

CONCLUSION.

It is as important for the jurisprudential system to be aware that, not only in criminal cases but in civil cases also, when a judgment is based upon a record devoid of evidence to sustain that judgment, there occurs a violation of the basic fundamental law of the land as enunciated in the Fifth Amendment.

For the foregoing reasons this petition for certiorari should be granted.

Respectfully submitted,

ARTHUR R. LITTLETON,
Counsel for Petitioners.

Of Counsel:
MORGAN, LEWIS & BOCKIUS,
123 South Broad Street,
Philadelphia, Pa. 19109.

Appendix.

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 17004

CONSOLIDATED SUN RAY, INC., SUN RAY DRUG CO., AND BARGAIN CITY U. S. A., INC.

v.

HARRY R. LEA AND ROSLYN T. LEA, CO-PARTNERS TRADING AS HARRY R. LEA & CO.,

Appellants

SUR PETITION FOR REHEARING.

Present: HASTIE, *Chief Judge;* and BIGGS, MCLAUGHLIN, KALODNER, FORMAN, SEITZ, VAN DUSEN and ALDISERT, *Circuit Judges.*

The petition for rehearing filed by HARRY R. LEA and ROSLYN T. LEA, Co-partners trading as HARRY R. LEA & Co., Appellants in the above entitled case having been submitted to the judges who participated in the decision of this court and to all the other available circuit judges of the circuit in regular active service, and no judge who concurred in the decision having asked for rehearing, and a majority of the circuit judges of the circuit in regular active service not having voted for rehearing by the court in banc, the petition for rehearing is denied.

By the Court,

WILLIAM H. HASTIE,
Chief Judge.

Dated: October 16, 1968

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 17004

CONSOLIDATED SUN RAY, INC., SUN RAY DRUG CO., AND BARGAIN CITY U. S. A., INC.

v.

HARRY R. LEA AND ROSLYN T. LEA, CO-PARTNERS TRADING AS HARRY R. LEA & CO.,

Appellants

(D. C. Civil Action No. 28404)

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF PENNSYLVANIA

Present: BIGGS, MCLAUGHLIN and FORMAN, *Circuit Judges.*

JUDGMENT.

This cause came on to be heard on the record from the United States District Court for the Eastern District of Pennsylvania and was argued by counsel.

On consideration whereof, it is now here ordered and adjudged by this Court that the order of the said District Court, filed September 28, 1967, be, and the same is hereby affirmed, with costs.

ATTEST:

THOMAS F. QUINN,
Clerk.

September 16, 1968

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 17004

CONSOLIDATED SUN RAY, INC., SUN RAY DRUG CO., AND BARGAIN CITY U. S. A., INC.

v.

HARRY R. LEA AND ROSLYN T. LEA, CO-PARTNERS TRADING AS HARRY R. LEA & CO.,
Appellants.

APPEAL FROM JUDGMENT OF THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF PENNSYLVANIA

Argued March 19, 1968

Before BIGGS, MCLAUGHLIN and FORMAN, *Circuit Judges.*

OPINION OF THE COURT

(Filed September 16, 1968)

By BIGGS, *Circuit Judge.*

I.

FACTS.

Consolidated Sun Ray, Inc. (Consolidated), Sun Ray Drug Co. (Sun Ray), a division of Consolidated, and Bargain City U. S. A., Inc. (Bargain City) have sued Harry R. Lea and Roslyn T. Lea (Lea), insurance brokers, alleg-

ing breaches of duty by Lea to the plaintiffs in failing to procure insurance. The suit at bar is concerned with losses incurred by the plaintiffs because of a fire at Bargain City which occurred on December 24, 1959. The court had before it stipulations of counsel and documentary evidence as set out in the footnote.[1] Both parties moved for judgment on the record. The court below granted the plaintiffs' motion and denied that of the defendants. Lea has appealed. The facts which can be garnered from the stipulation and the record follow.[2]

Consolidated was created by the merger on February 2, 1959 of Consolidated Retail Stores (Retail Stores) and Sun Ray. Bargain City was created as a joint venture by Consolidated and another company with which we are not concerned. Ninety percent of Bargain City's stock is owned by the public and five percent is owned by Consolidated.[3] Bargain City operates shopping centers, leasing space, furniture and equipment and providing services to concessionaires in return for a percentage of sales. Prior to the merger Lea had procured insurance policies from Eagle Fire Insurance Company (Eagle) and Eastern Fire & Casualty Company (Eastern) insuring Retail Stores by name against loss by fire and loss occasioned by business interruption due to fire damage. Insurance against business interruption is

---

1. We point out preliminarily that the trial of this case started before the late lamented Judge Allan K. Grim sitting without a jury and because of his death before completion of proof no decision was rendered. To avoid a retrial, the parties agreed to have the issue decided upon the record, consisting of the complaint (Document #1), the answer (Document #5), the plaintiffs' reply to new matter (Document #11), pretrial memoranda (Documents #7 and #8), request for admission of genuineness of documents (Document #12), and the answer thereto (Document #13).

2. The opinion of the court below is reported at 276 F. Supp. 132.

3. The remaining five percent is owned by Blauners, Inc., the other party to the Bargain City joint venture.

generally referred to as "U & O", "Use and Occupancy" insurance. Within a short time after the merger [4] Lea procured amendments to the policies from Eagle and Eastern naming "Consolidated Sun Ray, Inc. &/or any affiliated or subsidiary companies or corporations, A. I. M. A.," [5] effective on February 2, 1959 and specifically naming Bargain City as an insured as of February 10, 1959. The Eagle and Eastern policies were canceled as of July 1, 1959.

Upon being notified of the cancellations, plaintiffs requested that Lea replace the policies. Consequently, Lea contacted the Anka Agency, Inc. (Anka) and Anka in turn got in touch with The Steel Insurance Company of America (Steel), whose principal office appears to have been in Chicago, Illinois. There can be no doubt whatsoever from the record that Lea undertook to provide U & O coverage as provided for by the Eagle and Eastern policies except that payroll insurance, not here relevant, was to be excluded.[6] See the account of pertinent events as set out hereinafter.

At some point Anka had furnished Lea a brochure [7] respecting the nature of Steel's business. The first paragraph of this brochure states that Steel is chartered by Illinois as a "Capital Stock Fire Insurance Company.", and that "All business written is produced by qualified agents or brokers." The second paragraph states: "In addition to being an admitted company in Illinois . . . Steel

4. The exact time is not clear from the record. See note 3 cited to the text, 276 F. Supp. at 134.

5. This is an abbrevation for "As Interests May Appear."

6. On July 31, 1959 McGeer of Bargain City wrote Lea as follows: "Thank you for your letter of 7/23/59, advising of the replacement of the captioned [Eagle and Eastern] policies as of July 1, 1959. We assume that the coverage and rates afforded Consolidated Sun Ray is also applicable to Bargain City USA., Inc. and that we will receive a policy shortly with our name included. If there is any question in this connection, please advise the writer immediately." P's Exhibit I.

7. D's Exhibit 1.

. . . is also admitted in Ohio.", and that "The Company is a non-admitted or 'Surplus Line' insurer in all other States." and that "All surplus line business is handled on a brokerage basis through agents or brokers licensed in their own States." The quoted portions of the brochure put Lea on notice that any insurance issued by Steel outside of Illinois and Ohio, and in particular in Pennsylvania, was not written by Steel direct but through brokers and agents.

Anka is an insurance agent. On July 7, 1959, unknown to Lea until after the fire loss referred to had occurred, Luber, vice-president of Steel, wrote a letter to Kabat of Anka. The letter stated in pertinent part: "In line with our meeting of today this is to confirm our agreement along the following lines: 1. The Steel Insurance Company of America will recognize the Anka Agency, Inc. and Lindquist-Burns as our full and exclusive representatives in the Eastern States. However, it is understood that in the state of Pennsylvania we reserve the right to restrict your sole activities to the Philadelphia metropolitan area and in the state of New York your sole authorization does not encumber [sic] the Buffalo metropolitan. 2. In regard to Binding Authority you are hereby authorized to be able to bind for our Company risks to the extent of 10% of the total line. However, you shall not assume risk for the Company in excess of $150,000. 3. These lines are to be submitted to the Steel Insurance Company of America on a facultative basis with it clearly understood that all underwriting data should be in the hands of the Company within ten days from the assumption of liability." It is contended by the plaintiffs that the foregoing shows that Anka was without power to bind Steel in respect to the fire loss.

From early in 1959 a series of communications took place between plaintiffs, Seligman of Lea, Jenchel and

Kabat of Anka, and Steel. Jenchel was secretary-treasurer and Kabat was president of Anka. Kabat attended meetings with Seligman and discussed the replacement of the insurance cancelled by Eagle and Eastern. Kabat received from Lea a memorandum indicating the coverage of the Eagle and Eastern policies, the equivalent of which was to be provided for by Steel if Steel were to issue policies, and that the U & O coverage would be provided for with the exception of ordinary payroll insurance and that Bargain City should specifically be named as an assured.[8] It was further stipulated by the parties that Jenchel "presented this memoranda and notations to Mr. Morton Luber, Vice President of Steel . . . in July and discussed the same with him" and that "[a]s a result of that meeting . . . the [binders were] issued by Steel . . . covering Consolidated . . . , et al., and binders were issued covering . . . other . . . assureds."[9] Kabat's first contact with Steel had been in June, 1959. The binder insured "Consolidated Sun Ray, Inc., &/or any affiliated or subsidiary companies or corporations, as interest may appear" as of June 30, 1959 at 11:59 P. M. The original amount of the insurance was $500,000, subsequently raised to $750,000",[10] but the date the binder was signed does not appear from Lea's appendix.[11] The fact that coverage for loss of use and occupancy, "U & O", was not included is instantly apparent from an examination of the binder. It is also clear that Bargain City was not specifically included in the binder, albeit it is asserted by the appellants that the phrase "any affiliated or subsidiary

8. Paragraphs 7, 10(a), (b), (c), of the second stipulation of counsel.

9. Paragraph 10(d) of the second stipulation of counsel.

10. The effective date of the binder was given as "6-30-59".

11. See P's Exhibit R.

companies" was sufficient to include Bargain City. The printed form of the binder provided that it expired on the thirty-first day following the effective date of the binder or upon the delivery of a policy, "whichever shall first occur."

On July 23, 1959 Lea wrote McGeer of Bargain City stating: "Please be advised that as of July 1, 1959 we have replaced the above policies with [Steel]." The "above policies" referred to as replaced were the Eagle and Eastern policies. Paragraph 5 of Lea's letter stated: "Use & Occupancy coverage which is included in the form without additional charge is to exclude ordinary payroll." In fact, the terms of the policy which was eventually issued specifically excluded all U & O coverage and did not include protection for Bargain City by name.[12] McGeer wrote to Lea on July 31, 1959 and stated, among other things: "We assume that the coverage and rates afforded Consolidated . . . is also applicable to Bargain City . . . and that we will receive a policy shortly with our name included." McGeer added in a separate paragraph: "If there is any question in this connection, please advise the writer immediately."[13] On August 6, 1959 Seligman, as we have said, Lea's employee, wrote McGeer stating: "You are correct in that the rates afforded Consolidated . . . are also applicable to Bargain City . . . . You will be receiving a policy with your name included just as soon as it is issued."[14] Also on August 6, 1959, DeLucia, apparently an employee of Lea, wrote to Jenchel the following: "Please make certain that wherever Bargain City appears in the above policy [Consolidated] it

12. P's Exhibit AA.
13. P's Exhibit I.
14. P's Exhibit J.

reads: Bargain City U. S. A., Inc."[15] On September 18, 1959 Seligman wrote King of the "Sun Ray Drug Division" enclosing invoices and "your copy of the captioned policy."[16] Invoices were included which it is asserted by Lea showed that U & O coverage was included, and this fact seems not to be disputed by the plaintiffs-appellees. The letter states: "There are a number of endorsements which were inadvertently omitted from the policy, but they will follow as soon as received from the Company and in the meantime you are covered by binder for these endorsements."[17] Seligman on September 24, 1959 issued a memo to Jacobson, an employee of Lea, enclosing a copy of the letter of September 18 to Sun Ray and stated that the new Steel policy was to be checked against the Eastern policy and to send a binder "to company for all the things that are missing." In capital letters there follows the admonition, "Especially watch Use & Occupancy portion." "[G]o over these items with me but send binder over first."

The following appears from the second stipulation of counsel: "On November 16, 1959, Mr. Seligman not having received written confirmation of the U & O coverage inclusion and of fur and jewelry coverage in a number of the Steel policies went to Mr. Jenchel's office at Anka Agency and insisted that Mr. Jenchel call Steel Insurance Company to confirm that U & O coverage was as agreed. Mr. Jenchel placed a call to a Mr. Luber of Steel Insurance Co. and had a conversation with him in the presence of Mr. Seligman. Immediately after the telephone conversation, Mr. Jenchel dictated and then signed the document dated November 16, 1959 which document speaks for itself and is

15. P's Exhibit K.

16. The caption was "Steel Insurance Co. [Insurance Policy] No. 563."

17. P's Exhibit L.

Exhibit 3." [18] The letter referred to is D's Exhibit 3 and is as follows: "Effective November 16, 1959, we hereby agree to extend the above captioned Steel policies to cover Jewelry & Fur, subject to a minimum deductible of $250.00. Other deductibles to apply where policy deductibles are greater. No coverage will apply in show windows. This additional cover is subject to full information being supplied no later than Wednesday, November 18. On Consolidated Sun-Ray [*sic.*] it is understood that the policy is extended to cover U & O as per previous coverage in the Eagle Fire Insurance Co. [signed] "Anka Agency, Inc., Arthur S. Jenchel." [19]

It will be observed that it is stated that U & O coverage is extended "as per previous coverage in the Eagle Fire Insurance Co." but that Bargain City is not mentioned. Bargain City, as we have said was specifically covered by name in the Eagle policy by an endorsement dated "2-10-59" and was also so covered by the Eastern policy by an endorsement dated "2-10-59". The letter of November 16, 1959 did not put any time limit on coverage but the prior printed binder issued by Steel to the plaintiffs, as we have stated, was limited to thirty-one days.[20] Lea points out that other binders, for example, one that issued on November 16, 1959 had no time limitation [21] but this binder actually was issued by Anka and not by Steel. It is contended by Lea that the binder of November 16, 1959 was to have a longer tenure than thirty-one days, a tenure

18. Stipulation of counsel, Paragraph 9 "(i)".

19. D's Exhibit 3.

20. P's Exhibit G.

21. The binder stated that the "additional cover is subject to full information being supplied no later than Wednesday, November 18." The record does not show whether or not such information was furnished and since the parties have not mentioned it in their briefs nor the court below referred to it in its opinion, we will assume compliance with this provision.

continuing until a more formal document than the letter had issued covering Bargain City. Lea asserts that because Steel Policy No. 563, the policy sued on in the court below and, presently before us, was issued seventy-five days after the issuance of the original binder this makes plain the fact that the thirty-one day waiver was not considered to be effective by the parties.[22]

On November 23, 1959 Luber of Steel wired Jenchel of Anka: "Please cancel immediately binder covering jewelry [,] appliances and furs on all outstanding lines." It is contended by Lea that the wire demonstrates that Anka "did in fact have the right and authority to bind Steel."[23] It will be observed, of course, that Steel did not cancel the U & O coverage, a fact which, according to Lea, reinforced Lea's alleged reasonable belief that Steel had approved the issuance by Anka of the binder.

Within a comparatively short time thereafter, on December 4, 1959, Jenchel of Anka wrote Seligman of Lea, stating: "Confirming our telephone conversation of yesterday and once again my conversation today with Paul Borden [of Steel], I wish to advise you there is no coverage at all for any jewelry, fur or other similar items under any of the Steel Insurance Co. Policies. Our binder under which we extended these policies has been cancelled by the Company." Lea apparently accepted this cancellation without demur. No formal endorsement or binder was ever issued by Steel granting U & O coverage of Bargain City or naming Bargain City as an insured.

On December 11, 1959 Luber of Steel wrote a letter addressed to the "Insurance Buyer, Consolidated Retail Stores" stating that Steel was cancelling Policy No. 563 as

22. See the second Stipulation of Counsel, Paragraph 6, and P's Exhibit L.

23. Appellants' brief, pp. 19-20.

of December 31, 1959. The disastrous fire causing plaintiffs' losses occurred, as we have said, on December 24, 1959. The plaintiffs notified Steel of the loss and made demand for payment. Steel refused payment, denying liability.

On December 28, 1959 Seligman of Lea wrote a letter to Kabat of Anka, stating in pertinent part the following: "Re: Consolidated Sun Ray, Inc. et al. *Steel Insurance Co. Policy #563.* Dear Darwin: Confirming our discussion this afternoon, there are a number of outstanding endorsements due under the above policy all of which had been previously agreed to. Since we understand that the endorsements are not issued in your office, but by the Chicago office of the Steel Insurance Company, we ask that you please have all of the outstanding endorsements issued if they have not already been prepared by the company. Among the endorsements that we are awaiting are the following: . . . 2. Issue use and occupancy endorsement as per wording of Eagle Fire Policy No. NYIM 80015 which was previously submitted to the Steel Insurance Company except that coverage is excluded for ordinary payroll. 3. Include the name Bargain City U. S. A., in the title of the assured. . . . It would be appreciated if the endorsements have not been prepared by the Steel as of now that you secure their authorization to have the endorsements issued by your agency in New York. Please accept our thanks for your cooperation."[24] There was no response to this letter.

The plaintiffs brought three suits in the court below, two against Steel and the suit at bar against Lea. As stated in the opinion of the court below: "Steel defended the suits against it on the grounds, inter alia, that (a) Bargain City was not covered by the policy since it was neither (i) a named assured nor (ii) an affiliate or subsidiary of

24. D's Exhibit 22.

Consolidated; (b) U & O coverage was not afforded any assured since (i) the policy expressly excluded U & O coverage and (ii) Anka Agency was not authorized to bind Steel by any writing Anka might have issued purporting to bind such coverage; (c) plaintiffs had negligently or fraudulently failed to furnish complete information concerning their prior loss experience and thus the policy was procured by plaintiffs by material false and misleading statements; and (d) the policy had been issued to insure Consolidated only as to those locations comprising Retail Stores division of Consolidated." [25]

II.

Law.

The court below decided that the law of Pennsylvania was applicable and that Lea in failing to procure endorsements for U & O coverage and specifically naming Bargain City breached the duty owed the plaintiffs-appellees as an insurance broker. The court said: "Under Pennsylvania law, which is applicable in this diversity suit, whether the charge is negligence or breach of contract, the broker's conduct is measured by the same standard." [26], citing Talley v. Hoffman, 18 Pa. Dist. & Co. R. 2d 725, 729 (1959) as follows: "[A]n insurance broker is under a duty to exercise the care that a reasonably prudent businessman in the brokerage field would exercise under similar circumstances and if the broker fails to exercise such care and if such care is the direct cause of loss to his customer, then he is liable for such loss unless the customer is also guilty of failure to exercise care of a reasonably prudent businessman for the protection of his own property and business

25. 276 F. Supp. at 135.
26. *Id.* at 136.

which contributes to the happening of such loss."[27] The district judge also cited with approval, inter alia, 16 Appleman, "Insurance Law and Practice" § 8841, p. 510, which states: "Liability of Broker—Failure to Procure Insurance. An insurance broker is the agent of the insured in negotiating for a policy, and owes a duty to his principal to exercise reasonable skill, care, and diligence in effecting insurance. Thus he may be held liable where he has breached a contract to procure insurance for his principal. And while such broker is not obligated to assume the duty of procuring a policy, without consideration for his promise, he must exercise ordinary care in the performance of such duty when assumed, the promise to take the policy being a sufficient consideration. He is charged with the exercise of reasonable care and skill in making inquiries and obtaining information concerning the responsibility of the insurer with whom they place [sic.] the risk, and is liable for any loss occasioned by such want of care. If a broker or agent of the insured neglects to procure insurance, or does not follow instructions, or if the policy is void or materially defective, through the agent's fault, he is liable to his principal for any loss he may have sustained thereby. If the agent or broker fails to act with the proper and customary skill and care generally used by those in a like business, such neglect or breach of duty will render him liable in damages, not exceeding the amount of insurance he was employed to effect. It has been held that such principal may sue either for breach of contract or in tort for a breach of duty. It is generally considered that if the neglect or breach of duty of such broker results in loss to his principal, the broker is liable to the same extent as the insurer would have been liable had the insurance been properly effected, and must pay the resulting loss."[28] (Notes to the text omitted.) See

27. *Ibid.*
28. 276 F. Supp. at 136.

also Couch on Insurance, 2d, Vol. 3, § 25:55, § 25:57-59. The court below then discussed Lea's defenses, which were substantially the same as those asserted in this court, *i.e.*, that Lea had breached no duty and that not all of Steel's defenses were attributable to Lea's asserted breach of duty, and "unless all of Steel's defenses are attributable to [Lea's] fault, Lea cannot be held liable."[29] The trial judge went on to say: "I am satisfied by a preponderance of the evidence on this stipulated record that Lea's conduct fell below the standard prescribed for insurance brokers; that Lea's breaches of duty gave rise to all of Steel's colorable defenses in the suits on the policy and resulted in plaintiff's settlement of the suits on the policy at a substantial loss. Plaintiffs are entitled to be compensated for that loss."[30]

The court then discussed the "colorable" defenses raised by Steel. In substance these were that the plaintiffs had instructed Lea to procure an endorsement from Steel naming Bargain City as an assured, and while conceding that Lea failed to do this Lea asserted that no harm resulted from this failure because Steel's policy insured Consolidated and "its Affiliated or Subsidiary Companies or Corporations" and that Bargain City was an affiliate of Consolidated. Consolidated owned less than 5% of Bargain City's stock. The court below stated in its opinion: "Since plaintiffs have admitted that Bargain City is an affiliate of Consolidated, Lea argues that Bargain City was covered by the policy. . . ."[31] We can find no admission in the record by the plaintiffs that Bargain City was an affiliate of Consolidated. We are inclined to the view that Bargain City was not an affiliate. Section 1504 of the Internal Revenue Code, 26 U. S. C. A. § 1504, defines affiliation in part in terms of 80% ownership of the voting stock of the allegedly affili-

29. 276 F. Supp. at 136.
30. *Ibid.*
31. *Id.* at 137.

ated corporation. The predecessor statute, § 240(b) of the Revenue Act of 1918 was construed by a substantial body of case law, establishing that legally enforceable right to control the voting stock of any corporation was necessary for affiliation. See for example Handy & Harman v. Commissioner of Internal Revenue, 47 Fed. 2d 184 (C. C. A. 2nd, 1931). The Securities Act of 1933 also defines affiliation in terms of control. Section 5 of the Interstate Commerce Act, 49 U. S. C. A., § 5 provides an additional definition of affiliation. Again, the criterion is control. In McLean Trucking Company v. United States, 321 U. S. 67 (1944), this Act was construed in a situation where ownership of 9,000 shares out of 1,000,000 was held not to constitute affiliation. Black's Law Dictionary, 4th edition, page 80, defines affiliation as "legally enforceable control". The decision of such an issue is one fraught with peril for even the most skillful trial advocate and we are far from certain that Lea would have prevailed upon it had it been decided by Judge Grim in the original proceeding. The issue of the right of Anka to bind Steel also is a difficult one and there are others, all of which could be avoided had Lea carried out its undertaking to the plaintiffs-appellees to have Bargain City named in the policy and to have that policy include U & O coverage.

The court below also said: "The point in this suit is not whether Bargain City was in fact an affiliate of Consolidated and therefore covered by the policy, rather the issue here is whether the omission of Bargain City made available to Steel a defense it could not have raised if plaintiffs' instructions had been carried out. The answer to the pertinent question is obvious. Had Bargain City been named, its relationship with Consolidated would have been irrelevant; with the omission, the relationship became a matter of importance. Since Consolidated owned less than 5% of Bargain City stock, coverage for

Bargain City as an 'affiliate' was open to dispute, a dispute which would have been avoided if Bargain City had been specifically named as an assured. It may well have been for the purpose of avoiding such a dispute that plaintiffs instructed Lea to include Bargain City as a named assured." [32]

As we apprehend the lower court's opinion, the trial judge found that Lea's failure to obtain explicitly adequate authorized policy coverage as required by the plaintiffs resulted from Lea's failure to exercise the care that a reasonable and prudent insurance broker would have exercised under the circumstances. Lea points out, however, that it was stipulated that it is common practice to rely on oral and written binders until the issuance of a policy or an endorsement, and that Kabat, who represented Anka, was known to Seligman of Lea as a New York insurance broker of good reputation and of at least twenty years experience and that therefore Lea was entitled to rely on Kabat's representations and that the trial judge was in error in not so finding. We cannot agree, however, that under the circumstances at bar the trial court was in error in this regard. Lea's efforts to fulfill contractual obligations were palpably insufficient.

Lea contends, however, that the court below had before it no expert testimony as to what would be the standard of conduct of a reasonable and prudent insurance broker under the circumstances and that evidence as to such a standard was necessary. The decision most relevant to the case at bar that we have been able to find is Talley v. Hoffman, *supra* at 729 in which Judge Greevy of the Court of Common Pleas of Lycoming County stated "A principal may sue his agent to recover damages for all losses sustained by him because of the agent's breach of duty. The

32. 276 F. Supp. at 137.

general rule is that an agent, in executing his agency, is required to exercise the degree of care which an ordinarily prudent person would exercise under the circumstances. If he fails to exercise such ordinary care, he is liable to the principal for all losses sustained by him in consequence thereof. Specifically, an insurance broker is under a duty to exercise the care that a reasonably prudent businessman in the brokerage field would exercise under similar circumstances and if the broker fails to exercise such care and if such care is the direct cause of loss to his customer, then he is liable for such loss unless the customer is also guilty of failure to exercise care of a reasonably prudent businessman for the protection of his own property and business which contributes to the happening of such loss." See also Kovler v. Easterby, 79 D. & C. 102 (1951).[33]

We can find no Pennsylvania case directly in point on the issue as to whether negligence of an insurance broker must be proved by expert testimony but a decision of the Court of Appeals of Maryland is suggestive, we think, of what the Supreme Court of Pennsylvania might hold in a case similar to that at bar. In Lowitt v. Pearsall Chemical Corporation of Maryland, 242 Md. 245, 252, 219 A. 2d 67, 73 (1966), the Court of Appeals of Maryland held that expert testimony was not necessary to establish the degree of skill required of an insurance broker and that the broker's contention that the degree of skill and diligence usually employed by brokers under circumstances similar to those at bar could only be determined by expert

33. Since jurisdiction in this case is based on diversity of citizenship we apply the law of Pennsylvania including the conflict of laws rules of Pennsylvania. Klaxon v. Stentor Co., 313 U. S. 487 (1941). However, New York, the only other state jurisdiction whose law might be held by a Pennsylvania court to be applicable in the circumstances at bar, has the same test of liability of an insurance broker as that stated in Talley v. Hoffman, *supra*. See Fleetwood Motors, Inc. v. John F. Jones & Sons, Inc., 38 Misc. 2d 499, 237 N. Y. S. 2d 668 (Sup. Ct., Queens County 1963).

testimony was held to be incorrect. See Insurance Law and Practice, 16 Appleman, Section 8841 at 521. It is also the law that in an action against an insurance broker by an insured, the broker has the burden of proving that the insured suffered no actual damage by reason of the broker's breach of duty. See Appleman, *supra,* at 521.

Finally, Lea argues that it is necessary in order for the plaintiffs to recover that they demonstrate Lea's negligence was responsible for all Steel's defenses and produce evidence of specific monetary damages relatable to each defense. At an earlier point in this opinion we stated the defenses set up by Steel in the suit before Judge Grim. Not a single one of Steel's defenses would have been available to it if Lea had done what should have been done. One fact should be particularly noted in this connection: after the fire on December 28, 1959 Lea wrote Kabat of Anka and asked him to procure from Steel endorsements to include Bargain City as an insured. If Lea deemed Bargain City to be covered why the request for the issuance of endorsements after the calamity had occurred?

We agree with the court below that Lea cannot be conceived of as acting with the reasonable skill and diligence of an insurance broker. In our opinion, even viewing the facts *de novo,* we cannot but conclude as did the court below that Lea was guilty of negligence.[34]

We note that the defense of contributory negligence asserted by Lea against the plaintiffs has not been pressed

34. We recognize, of course, as Lea contends, that where the facts are stipulated to, no oral testimony being received, we may substitute our factual conclusions without the necessity of determining that the findings of fact of the lower court were clearly erroneous as required by Rule 52(a) Fed. R. Civ. Proc., 28 U. S. C. See In Re Kellett Aircraft Corp., 186 F. 2d 197 (3 Cir. 1950); and United States v. United Steelworkers of America, 271 F. 2d 676, 685 (3 Cir.), aff'd 361 U. S. 39 (1959).

on appeal. In any event we deem the defense to be without merit.

Lea also contends that the amount of the judgment has been wrongly calculated and is too large. But the court below stated in its opinion, 276 F. Supp. at 136, "The parties have agreed as to the computation and amount of the damages,[9] if they are to be awarded." Note 9 cited to the text sets up a calculation and damages of $580,023. The statement of Judge Luongo as to the agreement of the parties has not been demonstrated to be incorrect.[35] The judgment will stand as entered.

---

35. In so stating we do not pass upon the correctness of the calculation under the terms of the policy.

OPINION OF THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF PENNSYLVANIA.

LUONGO, *J.* September 28, 1967

This is a suit by Consolidated Sun Ray, Inc. (Consolidated), Sun Ray Drug Co. (Sun Ray), a division of Consolidated, and Bargain City U. S. A., Inc. (Bargain City) seeking damages from an insurance broker for alleged breach of duty in the placing of a policy of insurance. Defendants are Harry R. Lea and Roslyn T. Lea, co-partners trading as Harry R. Lea & Co. (hereinafter referred to as Lea or defendant).

Trial of this cause commenced before my late colleague Judge Allan K. Grim, sitting without a jury. Because of his untimely death before completion of the proof, no decision was rendered. To avoid a retrial the parties entered into extensive stipulations and have agreed to have the issue decided upon the record consisting of certain of the pleadings [1] and the aforementioned stipulations.[2] Included in the stipulations are references to memoranda and pleadings in other civil actions in this court which will be referred to hereafter. The matter is now before the court on cross-motions for judgment on that record.

FACTS.

The facts have been stipulated and there is no need to set them forth in extenso. They will be outlined at this juncture only to the extent necessary to make the controversy between the parties understandable. Reference will be made to other facts in the course of the opinion. Briefly stated, the facts are:

---

1. Complaint (document No. 1); Answer (No. 5); Plaintiffs' Reply to New Matter (No. 11); Pretrial Memoranda (Nos. 7 and 8); Requests for admission of Genuineness of Documents (No. 12); and Answer thereto (No. 13).

2. Documents Nos. 16, 17 and 20.

Consolidated was formed by the merger on February 2, 1959 of Consolidated Retail Stores (Retail Stores) and Sun Ray. Bargain Ctiy was formed as a joint venture by Consolidated and a corporation not involved in this proceeding. Approximately 90% of Bargain City's stock is owned by the public; ownership of the remainder is divided equally between Consolidated and the other joint venturer. Bargain City is in the business of operating shopping centers, leasing space, furniture and equipment, and providing services to concessionaires (including Sun Ray) in return for a percentage of sales. Prior to the merger of Retail Stores and Sun Ray, Lea had procured policies of insurance from Eagle Fire Insurance Co. and Eastern Fire and Casualty Company insuring Retail Stores against loss by fire and providing coverage against loss from business interruption due to fire damage. The business interruption clause is commonly referred to as the Use and Occupancy, or simply U & O, clause or coverage. Shortly after the merger Lea procured endorsements [3] from Eagle and Eastern amending the policies to change the name of the assured to "Consolidated Sun Ray, Inc. and/or any affiliated or subsidiary Companies or Corporations, AIMA*" effective February 2, 1959 and specifically naming Bargain City as an assured as of February 10, 1959.

For reasons not here relevant, the Eagle and Eastern policies were cancelled effective July 1, 1959. Lea undertook to replace the policies and agreed with plaintiffs to

3. Both counsel in their briefs referred to April 2, 1959 as the date of the issuance of the endorsements. It is apparent that the endorsements were issued earlier than that. In plaintiffs' Exhibits "E" and "F" attached to Document No. 16, letters dated March 10, 1959 from A. Seligman of Lea to Leon King of Sun Ray, and from Seligman to Reit of Retail Stores, reference was made to enclosed policies and attached endorsements effecting the change of name and adding Sun Ray and Bargain City for an additional premium in a provisional amount.

* Abbreviation for "As their interests may appear."

obtain a policy of insurance which would specifically name Bargain City as an assured, and which would provide the same Use and Occupancy coverage as contained in the Eagle and Eastern policies, excepting that ordinary payroll was to be excluded. Lea conducted negotiations with Anka Agency, Inc., insurance brokers, as a result of which a binder was issued by Steel Insurance Company [4] insuring Consolidated, effective July 1, 1959, against fire losses up to $750,000. By its terms, Steel's binder was stated to be effective only until noon of the 31st day following the effective date of the binder, or until the policy issued, whichever first occurred.

Steel's policy was received by Lea from Anka Agency on or about September 15, 1959 and was forwarded to Consolidated on September 18, 1959. Contrary to plaintiffs' instructions, the policy issued by Steel *excluded* coverage for Use and Occupancy [5] and did not name Bargain City as an assured. Lea's letter (Exhibit "L", Document 16) accompanying invoices to Sun Ray, Retail Stores and Bargain City for their respective portions of the premium on the Steel policy noted that several endorsements "were inadvertently omitted from the policy, but they will follow as soon as received from the Company and in the meantime you are covered by binder for these endorsements." Thereafter, discussions took place between Lea and Anka Agency as a result of which Anka, over the signature of Arthur Jenchel, its Secretary-Treasurer, issued a letter dated November 16, 1959 (Exhibit 3, Document No. 17) stating, in part: "On the Consolidated Sun Ray policy, it is understood that the policy is extended to cover Use & Occupancy

4. Steel retained only 2% of the risk, re-insuring the remainder with 11 other companies, the bulk of the risk being assumed by Lloyds' Underwriters (61.09%).

5. On the face of the policy (Exhibit "AA", Document No. 16) it was stated to be "without compensation for loss resulting from interruption of business."

as per previous coverage in the Eagle Fire Insurance Company."

On December 24, 1959, fire totally destroyed the Bargain City building at Horsham, Pennsylvania, causing a loss to plaintiffs from interruption of business and destruction of property well in excess of the $750,000 policy limits. At the time of the fire, Lea had not procured from Steel either the endorsement for Use and Occupancy coverage or the endorsement specifically naming Bargain City as an assured. Immediately after the fire, plaintiffs notified Steel Insurance Company of the loss and made demand for payment of the limits of the policy. Steel refused, denying liability. Plaintiffs thereupon instituted three suits in this court, two against Steel,[6] and the instant action against Lea. Steel defended the suits against it on the grounds, inter alia, that (a) Bargain City was not covered by the policy since it was neither (i) a named assured nor (ii) an affiliate or subsidiary of Consolidated; (b) U & O coverage was not afforded any assured since (i) the policy expressly excluded U & O coverage and (ii) Anka Agency was not authorized to bind Steel by any writing Anka might have issued purporting to bind such coverage; (c) plaintiffs had negligently or fraudulently failed to furnish complete information concerning their prior loss experience and thus the policy was procured by plaintiffs by material been issued to insure Consolidated only as to those locafalse and misleading statements; and (d) the policy had tions comprising Retail Stores division of Consolidated.[7]

6. Consolidated Sun Ray, Inc., et al. v. The Steel Insurance Company of America, Civil Action No. 28145; and Bargain City, Norristown, Inc. v. The Steel Insurance Company of America, Civil Action No. 29006.

7. Several other defenses, such as lack of jurisdiction over the defendant, insufficient service of process on the defendant, failure to state a claim upon which relief can be granted, were raised in the Answer, but they seem to have been raised perfunctorily. There is nothing in the record before me to indicate that any of the other alleged defenses had a semblance of support.

The two suits against Steel were consolidated for trial before Judge Grim, sitting without a jury. Plaintiffs attempted to consolidate the instant action as well, but the effort was resisted by Lea. Judge Grim did not act upon that motion to consolidate (the motion was subsequently withdrawn), but did require counsel for Lea to remain in attendance throughout the proceedings against Steel. After several days of trial, and largely through the efforts of Judge Grim, the suits against Steel were settled on April 15, 1965 for $475,000,[8] the settlement agreements expressly reserving to the plaintiffs whatever rights they might have against Lea. In the instant action, plaintiffs seek to recover the difference between the Steel policy limits and the amounts realized in settlement of the suits against Steel. The parties have agreed as to the computation and amount of the damages,[9] if they are to be awarded.

---

8. Lea has not questioned the reasonableness of the settlement. Lea's position has been that the amount of the settlement was reasonable only because it reflected Steel's major defense of "fraud" in the withholding of information on prior loss history, which defense Lea contended was not attributable to any fault of his. Defendant has conceded that if all of Steel's defenses are due to his fault, he is liable for the amount claimed by plaintiffs.

9. The policy required payment 60 days after the loss. The damages, including interest, are computed as follows:

Policy Limit	$750,000
Interest on $750,000 from 3/1/60 to 4/15/65	230,625
Amount due 4/15/65	$980,625
Received 4/15/65	475,000
Balance	$505,625
Interest from 4/15/65 to 9/28/67	74,398
Total	$580,023

DISCUSSION.

Plaintiffs claim that in failing to procure endorsements for U & O coverage and specifically naming Bargain City,[10] defendant breached the duty he owed to them as an insurance broker. Plaintiffs charge Lea with negligence and breach of contract. Under Pennsylvania law, which is applicable in this diversity suit, whether the charge is negligence or breach of contract, the broker's conduct is measured by the same standard. The duty was set forth in *Talley v. Hoffman,* 18 D. & C. 2d 725, 729 (1959), as follows:

> "[a]n insurance broker is under a duty to exercise the care that a reasonably prudent businessman in the brokerage field would exercise under similar circumstances and if the broker fails to exercise such care and if such care is the direct cause of loss to his customer, then he is liable for such loss unless the customer is also guilty of failure to exercise care of a reasonably prudent businessman for the protection of his own property and business which contributes to the happening of such loss."

See also *16 Appleman, Insurance Law and Practice,* § 8841, p. 300; *Walker v. Black,* 316 Pa. 395 (1907); *McCormack v. Shuman,* 11 D. & C. 2d 88 (1957); *Fry v. Barrett,* 55 D. & C. 640 (1945).

Lea contends, first, that he breached no duty and second, that if he did, not all of Steel's defenses were attributable to his breach, and unless all of Steel's defenses are

10. Plaintiffs also complained of Lea's failure to secure assumption agreements from re-insurers and failure to place the insurance with a company authorized to do business in Pennsylvania. With respect to these additional charges, I am satisfied that they were not a proximate cause of any harm to plaintiffs, consequently these additional charges will not be discussed further.

attributable to his fault, Lea cannot be held liable. I am satisfied by a preponderance of the evidence on this stipulated record that Lea's conduct fell below the standard prescribed for insurance brokers; that Lea's breaches of duty gave rise to all of Steel's colorable defenses in the suits on the policy and resulted in plaintiffs' settlement of the suits on the policy at a substantial loss. Plaintiffs are entitled to be compensated for that loss.

The colorable defenses raised by Steel were:

(a) *Bargain City was not covered by the policy.*

Plaintiffs instructed Lea to procure an endorsement from Steel naming Bargain City as an assured. Lea failed to do so, but contends that no harm resulted from the failure. The policy insured Consolidated and its "affiliated or subsidiary Companies or Corporations." Since plaintiffs have admitted that Bargain City is an affiliate of Consolidated, Lea argues that Bargain City was covered by the policy even though not identified by name therein. In effect, Lea's argument is that the inclusion of Bargain City by name was unnecessary, that it would have added nothing.

Lea's argument misses the point. The point in this suit is not whether Bargain City was in fact an affiliate of Consolidated and therefore covered by the policy, rather the issue here is whether the omission of Bargain City made available to Steel a defense it could not have raised if plaintiffs' instructions had been carried out. The answer to the pertinent question is obvious. Had Bargain City been named, its relationship with Consolidated would have been irrelevant; with the omission, the relationship became a matter of importance. Since Consolidated owned less than 5% of Bargain City stock, coverage for Bargain City as an "affiliate" was open to dispute, a dispute which would

have been avoided if Bargain City had been specifically named as an assured. It may well have been for the purpose of avoiding such a dispute that plaintiffs instructed Lea to include Bargain City as a named assured.

Lea's failure to obtain Steel's endorsement naming Bargain City resulted from Lea's failure to exercise the care that a reasonable and prudent insurance broker would have exercised. Inclusion of Bargain City as a named assured was a matter of importance to plaintiffs and Lea was aware it was. This is evident from the fact that after the merger of Retail Stores and Sun Ray, Lea acted promptly to obtain endorsements from Eagle and Eastern naming Bargain City. When those policies were cancelled, there was an exchange of correspondence between plaintiffs and Lea which reveals clearly the importance the parties attached to the inclusion. Several months elapsed between the date of issuance of the Steel policy and the fire. The record is devoid of any efforts by Lea to procure the outstanding endorsement in that interval. It was not until *after the fire* that Lea saw the need for action and wrote to Anka (Exhibit "P", Document No. 16) seeking issuance of the endorsement. The attempt was unsuccessful and, if anything, served to direct Steel's attention to the omission.

(b) *Policy did not afford Use and Occupancy coverage.*

Contrary to plaintiffs' explicit instructions to Lea to obtain a policy providing Use and Occupancy coverage, the policy issued by Steel expressly *excluded* such coverage. Again, Lea concedes his failure to obtain the endorsement from Steel, but denies that any harm resulted from the failure, contending that "there was in existence a valid and enforceable binder by an authorized agent of Steel Insurance Co. providing for the required coverage." (Defendant's brief, page 5.) Lea's argument, predicated upon the

aforementioned letter from Jenchel dated November 16, 1959, is that the letter ". . . *if issued by an agent of Steel,* is a valid enforceable binder providing U & O coverage similar to the previous coverage in the Eagle Insurance Co." (Defendant's brief, page 6. Emphasis in original.) The very phrase underlined by defendant's counsel pinpoints the weakness of that argument. Anka's agency and its authority to issue such binders was precisely the issue raised by Steel in the suits on the policy. Whether or not Anka had such authority is not controlling here. What is important in this proceeding is whether Lea failed to act reasonably and prudently in relying on that purported authority and, if so, whether such failure created another colorable defense for Steel. The defense was by no means frivolous. Steel denied Anka's authority to bind it for the U & O risk and pointed, with some justification, to its letter to Anka dated July 7, 1959 (Exhibit 26, Document No. 17) granting Anka limited authority to bind it.

Lea contends that he acted as a reasonable and prudent insurance broker in accepting the binder from Anka in lieu of Steel's endorsement. He points to the stipulation between the parties that it is common practice in the insurance business to rely upon oral and written binders until issuance of a policy or endorsement. It was not stipulated, however, that it is common practice, or that it is reasonable and prudent, for one insurance broker to accept another broker's purported authority to bind an insurance carrier on the flimsy evidence of authority on which Lea acted here. Lea had never before dealt either with Steel or with Anka. Lea had no specific knowledge nor did he make any inquiry as to Anka's authority to bind Steel. He was not aware of Steel's letter of July 7 until *after* the fire, consequently knew nothing either of the grant of authority or the limits on Anka's authority to bind Steel. There is no evidence of a history of prior dealings between Anka and

Steel from which Lea might reasonably have inferred that Anka was authorized to bind Steel. What Lea relied on was meager indeed: that Anka's president was a reputable, experienced broker (whose company presumably would not issue binders for a carrier unless authorized to do so); that Anka had furnished to Lea a three-page brochure about Steel; and finally, that the alleged binder was issued by Anka following a telephone call between Anka and an officer of Steel Insurance Co.

The telephone call referred to took place some two months after issuance of the policy. Apparently concerned over the lack of written confirmation of U & O coverage, a Lea employee visited Anka Agency. While he was there an Anka representative telephone a Steel officer. After the telephone call the letter containing the alleged binder was issued. But the Lea employee had not participated in the telephone conversation with the Steel officer and the record does not reveal what transpired between the Anka and Steel representatives. The letter issued by Anka contained no notation that a copy had been sent to Steel. There was nothing to indicate that Steel had been put on notice of, or had acquiesced in, the issuance of the letter "binder". A reasonable and prudent insurance broker would not have relied on such a "binder" without more evidence and assurance of authority.

Apart from the unreasonable reliance upon Anka's purported authority, Lea failed to exercise reasonable care *after* the issuance of the alleged binder. The "binder" was dated November 16, 1959. The fire occurred some 40 days later. In that interval, Lea had obtained neither an endorsement from Steel, nor written confirmation of the "binder". The passage of such a period of time was particularly significant in light of the p[illegible]ted condition on the formal binder *issued by Steel* (Exhibit "G", Document No. 16) that it was only effective until and expired at noon on

the 31st day following the effective date of the binder. Since the formal binder issued by Steel was, by its terms, effective only for 31 days, Lea did not exercise reasonable care in relying, for a period of time longer than 31 days, upon an informal binder issued by an alleged agent, without written confirmation from the principal.

(c) *Withholding of information by plaintiffs.*

Lea contends that, even assuming he was derelict in failing to obtain the endorsements naming Bargain City and providing Use and Occupancy coverage, he may nevertheless not be held liable to plaintiffs since their loss was not due *solely* to Lea's breaches. It is Lea's position that one of the major defenses asserted by Steel in the suits against it was that the policy was obtained by the deliberate or negligent withholding by plaintiffs of information of Sun Ray's and Bargain City's loss history, and contends therefore:

> "If one of the meaningful defenses of the insurance carrier is not related to any action of the broker, the insured cannot recover against the broker for the difference between the settlement figure and the policy limits since there is no method or evidence whatsoever to demonstrate the influence of each defense upon the settlement." (Defendant's brief, page 13.)

This contention is based upon counsel's interpretation of *Hilton v. Federated Brokerage Group, Inc.*, 213 N. Y. S. 171 (1961). It will not be necessary to consider whether the quoted portion of defendant's brief is an accurate statement of the law since I conclude that Steel's defense was attributable to Lea's conduct. Plaintiffs reasonably relied upon Lea to tell them what information was required in connection with the placing and the maintaining of policies of

insurance. From correspondence [11] it appears that Lea was concerned with and sought from plaintiffs only information relating to locations and value of the contents of the Sun Ray and Bargain City stores. Plaintiffs furnished such information as Lea requested of them, albeit at times tardily. There were no direct dealings at any time between Steel and plaintiffs. Whatever information Steel required of plaintiffs it sought and obtained through Lea, and plaintiffs, in turn, relied upon Lea to inform them what information was required. If prior loss history was of importance in placing the policy, it was Lea's responsibility to know that and it was Lea's duty to seek out the information from plaintiffs. Consequently, if there was any substance whatsoever to Steel's defense concerning the failure to furnish information as to prior loss history, that defense was likewise attributable to Lea's fault.

(d) *Policy intended to cover only Retail Stores.*

This was another defense asserted by Steel but neither side in this case has commented much upon it. Steel contended that the policies were intended to apply only to outlets of Retail Stores, not to locations of Bargain City or Sun Ray. If there was any merit at all in that defense it would appear clearly to be due solely to the fault of Lea. There is no room for dispute on that issue in this record. Plaintiffs and Lea clearly intended coverage for Sun Ray and Bargain City stores. It was Lea's responsibility to obtain such coverage from the carrier.

CONCLUSION.

Lea breached the duty of care which he, as an insurance broker, owed to the plaintiffs, his clients. Lea's breach of duty gave rise to all of the insurance company's colorable

11. See, for example, letters marked Exhibits "C", "E", "L", and intra-company memorandum marked Exhibit "M", all attached to Document No. 16.

defenses to plaintiffs' suit on the policy, causing plaintiffs substantial loss for which they are entitled to an award of damages against Lea.

Plaintiffs' motion for judgment on the record will be granted. Defendant's motion for judgment will be denied.

ORDER OF THE U. S. DISTRICT COURT FOR THE EASTERN DISTRICT OF PENNSYLVANIA.

AND Now, this 28th day of September, 1967, it is ORDERED that the Motion of defendants, Harry R. Lea and Roslyn T. Lea, co-partners trading as Harry R. Lea & Company, for Judgment be and it is hereby DENIED.

It is FURTHER ORDERED that the Motion of plaintiffs, Consolidated Sun Ray, Inc., Sun Ray Drug Co. and Bargain City U. S. A., Inc. for Judgment be and it is hereby GRANTED and judgment is entered in their favor against defendants, Harry R. Lea and Roslyn T. Lea, co-partners trading as Harry R. Lea & Company, in the sum of Five Hundred Eighty Thousand and Twenty-three ($580,023) Dollars.

ALFRED L. LUONGO, *J.*